

Variation in Medicare per capita spending

ISSUE: Can we develop a better system for paying Medicare+Choice plans? The Commission has recommended that payment rates in Medicare+Choice should reflect per capita local fee-for-service spending. To effectively implement this recommendation, three issues should be addressed. First, we should define payment areas that can serve as a reasonable basis for calculating payments. Second, CMS should develop an effective system for adjusting payments for differences in enrollees' risk. Third, we should identify the factors that affect variation in per capita local spending and then determine which factors should be controlled for in the payment system. In this analysis, we start this process by estimating how much of the variation in per capita spending in the current system is attributable to several factors, which provides useful information for choosing appropriate policies to address the variation.

KEY POINTS: Factors that affect variation in per capita local spending in traditional Medicare include:

- per unit costs of inputs (input prices) such as wages for hospital personnel;
- payments to teaching hospitals in the form of direct and indirect graduate medical education payments (GME and IME);
- payments to hospitals for indigent care in the form of disproportionate share payments (DSH);
- beneficiaries' health status;
- beneficiaries' service use, including the effects of providers' practice patterns and beneficiaries' propensity to use care; and
- beneficiaries' use of Medicare-covered services in facilities operated by the Departments of Veterans Affairs (VA) and Defense (DoD).

We found that input prices have by far the largest effect on variation, followed by health status and then DSH, IME, and GME payments. Removing all five factors reduces the variance by 62 percent. Due to data limitations, we cannot estimate directly how much variation is attributable to beneficiaries' service use and how much is their use of VA and DoD facilities. We surmise that differences in service use has a much larger effect than does differences in use of VA and DoD facilities.

ACTION: Analysis of variation in per capita fee-for-service spending is intended to be part of a chapter in the March 2003 report that will address improving the payment system in Medicare+Choice. At this meeting, staff seek feedback on whether we have identified the appropriate sources of variation and on our method for estimating the variation attributable to each source. In upcoming meetings, staff will give presentations on whether payment areas should be changed to improve the M+C payment system and on the effectiveness of the risk adjustment system proposed by CMS for use beginning in 2004.

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